

ARE DIVIDENDS DISAPPEARING? MIXED EVIDENCE FROM EUROPE

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ABSTRACT

Recent empirical studies reported the phenomenon of low propensity of firms to dividend payment, concluding that companies have become less likely to pay dividends. In addition, most of these studies claim that investors' expectations regarding dividend payments also decreased.

We analyse the propensity to pay dividends in three European markets: Portugal, France and the UK. Although they are all European markets, they differ from each other for several reasons. Firstly, the UK is one of the largest European capital markets, whereas the French and Portuguese markets are smaller, especially Portugal. Additionally, these latter two markets are less intensively researched. Secondly, these countries differ in terms of ownership concentration. In Portugal and France ownership tends to be more concentrated than in the UK. Thirdly, Portugal and France are bank-based financing systems, whereas the UK is a market-based system. Finally, the legal rules covering protection of corporate shareholders are different in the three countries.

We find evidence of the decline of firms paying dividends in Portugal and in the UK, but not in France. Moreover, we find some evidence that firms that pay dividends tend to be the ones of larger size and higher profitability, but we find no evidence of a significant relation between a firm's growth and dividend payments.

Key Words: Cash Dividends, Dividend Payments

JEL Classification: G35, G32

1. INTRODUCTION

Recent empirical studies reported the phenomenon of low propensity of firms to dividend payment, claiming that investors' expectations regarding dividend payments also decreased. However, Julio and Ikenberry (2004) found evidence that this trend made a sharp reversal in the US market starting in 2000.

Fama and French (2001) found evidence that the number of firms that pay dividends has decreased significantly during the 1980's and 1990's, since in 1978, 66.5% of firms listed on NYSE, AMEX and NASDAQ (excluding financial organizations and public utility) distributed dividends, while in 1999 this percentage was only 20.8%. The authors state that there are three main factors for the dividend payment decision, which are profitability, growth and firm size. The firms that pay dividends tend to be the ones of larger size, higher profitability, but the ones having fewer growth opportunities. On the whole, and apart from these characteristics, firms tend to pay fewer dividends.

Loderer and Roth (2005) studied also a sample of firms traded on the NYSE, AMEX and NASDAQ, but in the period 1926-2002, founding evidence that the importance of ordinary dividends as a means of cash distribution has fallen during the past three decades to a level between 10% and 49%.

Banerjee, Gatchev and Spindt (2002) analysed the period between 1963 and 2001, taking into account the three factors defined by Fama and French (2001), and conclude that larger and more profitable firms pay higher dividends, while those that have more growth opportunities pay lower dividends, which is consistent with the former authors' results. In addition, they conclude that the inferior propensity to dividend payment is not significantly influenced by fiscal reasons or by a firm's share repurchase policy.

Several authors conclude that one of the best explanations for the disappearance of dividends is offered by the *catering theory of dividend*¹[Baker and Wurgler (2004)], such as Baker and Wurgler (2004) and Bulan, Subramanian and Tanlu (2005), in the US and Ferris, Sen and Yui (2006), in the UK. In addition, Bulan, Subramanian and Tanlu conclude that repurchases and dividends play different roles, not being substitute methods of paying out cash and Baker and Wurgler, in accordance with DeAngelo,

¹ According to the authors, the catering theory supports the idea that firms tend to pay dividends when the share prices of the firms that distribute dividends are higher than those that do not pay it.

DeAngelo and Skinner (2004), find no support for the asymmetric information theory or the clienteles' theory in influencing, at least in a significant way, the propensity to pay dividends.

Recently, DeAngelo, DeAngelo and Stulz (2006) found evidence of no change in the companies' propensity to pay dividends from the mid-1970s to 2002 for the companies with negative retained earnings. However, the other firms have a propensity reduction that is approximately twice the overall reduction in Fama and French (2001).

Although the evidence of firms declining the propensity to pay dividends, Julio and Ikenberry (2004) note that this trend makes a sharp reversal starting in 2000, founding evidence of the reappearance of dividends in the US market. They mention five possible reasons why dividends are reappearing: (i) maturity hypothesis, with firms paying out excess free cash flow (young companies during the 1990s are now reaching adolescence); (ii) signalling and governance functions of dividends, with firms using dividends to signal the market; (iii) the recent US dividend tax cut (May, 2003); (iv) irrational investors preferences for dividends (behavioural finance); (v) corporate payout policy appears to be shifting back in favour of conventional cash dividends.

Recent studies extend the analysis to other countries in addition to the US.

Reddy and Rath (2005) analyse the impact of profitability, size and growth on the dividend payout of Indian firms over the 1990-2001 period. Their results document a decline in the percentage of Indian firms paying dividends, from 60.5% in 1990 to 32.1% in 2001. Further, they found that dividend-paying firms are more profitable and larger in size than non-paying firms, which is in agreement with Fama and French's (2001) results. However, they found no significant relation between a firm's growth and dividend payments.

Osobov (2004) analyses corporate dividend decisions of firms from the US, Canada, UK, Germany, France and Japan, for the period between 1981 and 2002. The results indicate a decline in the propensity of firms to pay dividends in all countries, although the magnitude of the decline and the percents of payers at the end of the study vary across countries. The author evaluates whether firm size, profitability and growth opportunities affect dividend decisions. Larger and more profitable firms are more likely to pay dividends in all countries, while the effect of growth opportunities depends on the country's legal origin. Consistent with the findings of La Porta *et al.* (2000) and

Fama and French (2001), the relationship between growth opportunities and the likelihood of dividend payments in the US, Canada and UK is negative. However, in Germany, France, and Japan it is mixed. His results are consistent with the agency theory, but cast some doubts on equilibrium clientele theories and on signalling theories as candidate common explanations of the declining propensity to pay dividends. Moreover, Osobov, like Fama and French (2001), finds no significant relationship between the propensity to pay dividends and share repurchases.

Foester and Sapp (2006) find evidence that dividend payout ratio of Canadian firms' decreases since the World War II. Their results suggest that investors' perception of dividends has changed over time, allowing management to pay smaller dividends and reinvest funds in the firm. They do not support the dividend signalling hypothesis.

Ferris, Sen and Yui (2004) analyse eleven common law and fourteen civil law countries² over the period from 1990 to 2001. In general, their findings are consistent with patterns observed for US firms. They find that the propensity to pay dividends declines over their sample period and is most pronounced for firms incorporated in common law countries. At the beginning of their sample period, 81.4% of the sample firms pay dividends, but by 2001, this value declines to 58.3%. The US and Canadian firms exhibit the greatest decrease in the number of dividend payers. The growing incidence of non-dividend paying firms is explained by the increase in the percentage of firms that have never paid dividends. Furthermore, Ferris, Sen and Yui find that firms in common law countries tend to be more profitable, to have more abundant growth opportunities and to be bigger than their civil law counterparts.

Two years later, Ferris, Sen and Yui (2006) focus on the UK market. They find that the number of UK firms paying dividends declines from 75.9% in 1988 to 54.5% in 2002, being the decrease concentrated over the last five years. The authors conclude that the declining propensity to pay dividends in the UK is smaller in magnitude than that observed in the US and appears only recently. In addition, they find that tax law revisions in 1997 fail to influence dividend policy by UK firms. Furthermore, the authors analysed the simultaneous impact of size, profitability and investment opportunities on the firm's decision to pay dividends. The results show that firm size

² The classification of the countries between common or civil law was based on La Porta *et al.* (1998). Examples of common law countries are Australia, Canada, Hong Kong, Thailand, UK and US, and civil law countries are Japan, France, Italy, Germany, Spain and Switzerland.

and profitability are significantly positive influences on the decision to pay dividends, and investment opportunities reduce the likelihood of paying dividends³. This finding is consistent with those of Fama and French (2001) and Banerjee, Gatchev and Spindt (2002), among other authors.

In this paper we intend to characterize the evolution of dividend payment in three different European markets, in order to better assess the generality of the claimed lower propensity for dividend payment.

We find mixed evidence regarding the decreasing trend in dividend payment. While the Portuguese data clearly reveals a reduction in the number of dividend payers and in the amount paid out, the same effect is not so pronounced for the UK, where the percentage of dividend payers is quite stable during the sample period. In striking contrast, the French data reveal an increase in the number of dividend payers.

Moreover, we find some evidence that firms that pay dividends tend to be the ones of larger size and higher profitability, but we find no evidence of a significant relation between a firm's growth and dividend payments.

The remainder of this paper is organised as follows. Section 2 presents the sample selection. Section 3 presents and discusses the empirical results and section 4 provides the conclusion.

2. SAMPLE SELECTION

The sample is drawn from dividend announcements of firms listed on the Euronext Lisbon (EL), Euronext Paris (EP) and London Stock Exchange (LSE) during the period 1988-2002, 1992-2002 and 1994-2002, respectively for the Portuguese, French and the UK markets⁴.

We consider all the non-financial listed firms whose data were available on *Datastream*. The dates of our analysis allow a partial overlap with previous authors' studies, thus making possible a comparison of dividend practices among the different markets.

³ Benito and Young (2001) studied also the UK market, reporting an increase in dividend omissions since 1995, attributing it to a growing number of firms with strong investment opportunities.

⁴ These different periods are determined by the availability of the information obtained from EP and SLE about the firms listed each year in the respective stock Exchange.

We classify the sample firms according their dividend policy. We identify a firm as a *dividend payer* in year t if it pays a dividend in year t , and as *dividend non-payer* a firm that does not pay a dividend in year t .

3. EMPIRICAL RESULTS

We start this section by presenting the trends in the dividend payment pattern of the non-financial listed firms on the three markets, and then we make a comparative analysis of firm characteristics between dividend payers and non-payers.

3.1. TRENDS OF DIVIDEND PAYMENTS OVER THE SAMPLE PERIOD

Table 1 shows the total number of non-financial firms listed on EL, EP and LSE each year during the period considered in each country, and the number of firms that, for each year, pay cash dividends (dividend payers) and do not pay cash dividends (dividend non-payers), according to the information available on *Datastream* database.

The Portuguese market is smaller than most other Western European markets, namely the UK and France, as we can see by the smaller number of non-financial listed firms. We should emphasise the significant decline in the total number of non-financial firms listed on EL during the sample period. It has fallen from 140 in 1988, to 43, in 2002, representing a decline of about 69.3%. The decline along the period is due, in part, to firms disappearing through merger and acquisitions or bankruptcy. The Portuguese market specificities of instability, illiquidity and thin trading influence this general behaviour. Although this decline is continuous, it is sharp from 1991 to 1992. During this specific period the market suffered a structural and functional reform, with the publication of the Securities Market Code and the establishment of the Portuguese Securities Market Commission (CMVM). The new rules of supervision and market regulation lead to a significant number of delisted firms.

The number of non-financial firms that paid dividends has fallen continuously from 93 firms in 1988 to only 18 in 2002. However, the percentage of companies paying dividends has declined only from 66.43% in 1988 to 41.86% in 2002. This is explained by the fact that the total number of firms listed on EL also declined significantly, as can be seen also in Figure 1. In the last two years the percentage of firms that do not pay

dividends became higher than that of dividend payers, which coincides with a period of market recession.

In France, the total number of non-financial firms listed on EP has decreased continuously during the sample period. It has decreased from 414 firms in 1992, to 224, in 2002. However, the number of non-financial firms that paid dividends has grown continuously from 1992 (101) to 2001 (150), representing an increase of 48.5%. However, from 2001 to 2002, the number of dividend payers has fallen to 146, but we cannot say firms become less likely to pay dividends, as the total number of non-financial firms has also declined. The percentage of dividend payers increased from 24.40% to 65.18% in the 1992-2002 period. The difference between absolute and relative values is due to the relevant decrease of the total number of non-financial firms listed on EP. Surprisingly, in 1999, the number of dividend payers became higher than that of dividend non-payers, and this relation is maintained until 2002 (Figure 1).

The UK is the largest capital market in our study. It shows an increase in the total number of non-financial firms listed on LSE during the period from 1994 to 2000, in contrast to what happens in Portugal and France. It has increased from 753 firms in 1994, to 984, in 2000. However, this number declined during the two subsequent years, and, in 2002, this number has declined to 940. In fact, the year 2001 was characterised by a slowing down in the world economic growth, which can explain this evolution. The number of non-financial firms that paid dividends has increased continuously from 1994 to 2000, but it has decreased in 2001 and 2002. In spite of the decrease in the number of dividend payers, in percentage it does not show, because the total number of non-financial firms has a more pronounced decline. The percentage of dividend payers is slightly higher than the percentage of non-dividend payers (Figure 1). The same evidence was found by Osobov (2004) and Ferris, Sen and Yui (2004)⁵.

Overall, the evidence found in several recent studies of the decline of firms paying dividends in different markets, such as the US market [Fama and French (2001) and Baker and Wurgler (2004)], several common and civil law countries, including

⁵ Our numbers for the French and the UK markets differ from the ones of Osobov (2004) and Ferris, Sen and Yui (2004). The first author collected his data from *Worldscope* database and the latter authors obtain the data on the July 2002 edition of the *Company Analysis* database. We obtain the number of firms listed in each year directly from EP and LSE, and the information of dividend payers in *Datastream* database. In 2001, the last common year for the three studies, the percentage of dividend payers for the French market was 59.3%, 62.9% and 61.7% and for the UK market was 53.0%, 60.4% and 53.1%, respectively in the Ferris, Sen and Yui, Osobov and in our study.

European Markets [Ferris, Sen and Yui (2004) and Osobov (2004)] and the Indian market [Reddy and Rath (2005)] are consistent with our findings for Portugal, and, partially for the UK, but in contrast with French results. Moreover, the results suggest that European markets have higher percentages of dividend payers⁶.

Table 2 contains some summary statistics concerning the DPS.

In Portugal, the average DPS, has ranged from 0.15 (2002) to 0.64 Euros (2001) and the maximum value has ranged from 0.70 (2002) to 10.47 (2001). The last two years present very different values for the average DPS, being 2001 the year with the higher standard deviation (2.16). However, this year is highly influenced by a unique dividend of 10.47 euros. If we ignore this dividend, we will have an average of 0.19 (one of the lowest), a maximum value of 1.00 and a standard deviation of 0.24, as it can be seen in Figure 2, as well as by the lowest values for the minimum DPS both in 2001 and 2002, of 0.01 euros, which is more consistent with the recession period of 2001-2002. The fact that the percentage of firms paying dividends has been relatively constant whereas the average dividend paid has decreased, namely in the 1995-2002 period, implies that companies which have been paying dividends have paid lower amounts, except for a small number of larger firms.

In France, the DPS values are highly influenced by a unique firm with extreme dividends (in average, above 90 Euros), as we can see in Figure 2. Thus, we decide to ignore this firm for DPS analysis. According to Table 2, the average DPS (Euros) has ranged between 1.34 (1996) and 1.91 (1993). The average DPS has been stable in the last five years, with an increase tendency, which is consistent with firms smoothing their dividends. The minimum DPS is also stable. The higher movements are observed in the maximum dividends that ranged from 1992 to 2002 between 10.98 (1996) and 52.85 (1993 and 1994).

In the UK market, the average DPS values (£) have increased continuously from 6.33, in 1994 to 9.83, in 2002. The tendency of a continuous increase in the average DPS could be interpreted as an indication of firms smoothing their dividends. The high values for the standard deviation can be explained by the significant different between the minimum and maximum values of DPS. The UK firms pay higher dividends than

⁶ In 1999, the percentage of firms paying dividends in the US market was 20.8% [Fama and French (2001)], in India was 32.1% [Reddy and Rath (2005)], and we find a percentage of 67.86% for Portugal, 53.14% for France and 53.17% for the UK market.

the Portuguese and French markets, probably because it is one of the most important European capital markets.

We analysed industry trends from the length period and the results do not show significantly evidence of industry and countries effects in dividend payments⁷.

3.2. CHARACTERISTICS OF DIVIDEND PAYERS

Several authors report that dividend policy is linked to firm profitability, size and its investment opportunities, such as Smith and Watts (1992) and Barclay, Smith and Watts (1995). In addition, several authors examine these variables in their studies of dividend trends, such as Fama and French (2001) and Banerjee, Gatchev and Spindt (2002), for the US market and Ferris, Sen and Yui (2006), for the UK market.

We provide a similar analysis, testing whether the different dividend groups on the Portuguese, French and the UK samples differ from each other on the basis of profitability, size and investment opportunities.

A. Size

We begun our analysis comparing the size between payers and non-payers, based on total assets [Ferris, Sen and Yui (2006)]. As we can see in Table 3, dividend payers are larger than non-payers. However, the difference is not statistically significant in the case of the Portuguese sample.

B. Profitability

To analyse the difference on profitability between the two groups, we focus on earnings before taxes but after interest, standardized by total assets. For both the Portuguese and the UK sample, the mean profitability of dividend payers is higher than that of non-payers, and the difference is statistically significant. In the case of the French sample, the results contradict the other two markets, with dividend non-payers being more profitable than their counterparts, but the difference is only significant at the 10% level.

⁷ The results are not reported, but are available under request.

C. Investment Opportunities

For the analysis of corporate investment opportunities across dividend payers and non payers, we consider the asset growth [Fama and French (2001)]. We find that the difference between dividend payers and non-payers is statistically significant only for the Portuguese sample, which show that dividend payers demonstrate higher asset growth rates than dividend non-payers.

D. Simultaneous Effects

We run a logit regression of the simultaneous impact of size, profitability and investment opportunities on the firm's decision to pay dividends.

The dependent variable assumes the value one in year t if the firm pays a dividend in that year and zero otherwise. The independent variables are the log of total assets (size), the asset growth rate (investment opportunities) and the earnings before taxes but after interest, standardized by total assets (profitability). The results can be seen in Table 4.

We observe that firm size is significantly positive influence on the decision to pay dividends in the French and the UK samples. In what concerns the profitability, the results show that they contribute positively for the payment of dividends in the cases of Portugal and the UK. That is, firms with higher profitability are more likely to pay dividends. Finally, the coefficient on assets growth is only statistically significant for the Portuguese sample, and at 5% level. Thus, we find only weak evidence for investment opportunities influencing the likelihood too pay dividends. Summarising, firm size and firm profitability appears to increase the likelihood that a firm will pay dividends.

These last results are in accordance with the ones of Fama and French (2001), Osobov (2004), Reddy and Rath (2005) and Ferris, Sen and Yui (2006), among others.

4. CONCLUSIONS

The evidence found in several studies of the decline of firms paying dividends in different markets, such as in the studies of Fama and French (2001), Baker and Wurgler (2004), Osobov (2004) and Ferris, Sen and Yui (2004, 2006), are consistent with our

findings for Portugal, and, partially for the UK, but in contrast with the evidence for France. In fact, we find that firms become less likely to pay dividends in the Portuguese and, for the recent years, in the UK market, but not in the French market.

The results suggest that European markets have a higher percentage of dividend payers than other markets, despite the decreasing value of dividends paid. The UK firms pay the highest dividends of the samples, probably because it is one of the most important European capital markets.

Moreover, we find evidence suggesting some smoothing dividend policy in France and in the UK. In a companion paper, Vieira and Raposo (2007) find evidence suggesting that the Portuguese market does not have a smoothing dividend policy like the US or the UK markets, but rather a more volatile dividend policy, such as in Germany [Goergen, Renneboog and Silva (2005)].

Finally, we find evidence that firms that pay dividends tend to be the ones of larger size (in the French and the UK markets) and of higher profitability (in Portugal and in the UK). These results are in accordance with several authors, such as Fama and French (2001), Reddy and Rath (2005) and Ferris, Sen and Yui. (2006). Moreover, we find no evidence of a significant relation between a firm's growth and dividend payments, like Osobov (2004).

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